IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

MARY BAIN PEARSON and JOHN MASON, **Plaintiffs,** **v.** **ANDREW S. FASTOW, et al.,** **Defendants.**	Civil Action No. H-02-0670 Consolidated Lead H-01-3624
RUBEN and IRENE DELGADO, and PRESTON CLAYTON, **Plaintiffs,** **v.** **ANDREW S. FASTOW, et al.,** **Defendants.**	Civil Action No. H-02-0673 Consolidated Lead H-01-3624

DEFENDANT ARTHUR ANDERSEN LLP'S MEMORANDUM OF LAW IN OPPOSITION TO PLAINTIFFS' MOTION TO REMAND

Defendant Arthur Andersen LLP ("Andersen") respectfully submits this memorandum in opposition to the motions to remand filed by Plaintiffs in Pearson v. Fastow, No. H-02-0670 and

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Delgado v. Fastow, No. H-02-3624.[1] For the reasons set forth below, both motions should be denied.

INTRODUCTION

This Court has already held that Fleming & Associates, LLP ("Fleming") is attempting to circumvent the clear dictates of the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), Pub. L. No. 105-353, 112 Stat. 3227, through the exploitation of an empty procedural device. Newby v. Enron Corp., No. 01-CV-3624, mem. op. at 4 (S.D. Tex., Feb. 15, 2002) (hereinafter "Fleming Firm Order"). By dispersing the firm's clients into multiple cases filed in different districts, each with fewer than 50 plaintiffs, Fleming argues that one of the requirements of SLUSA for removal (that a case be a class action, or brought on behalf of more than 50 plaintiffs) is not met.[2] Of course, the reality is that Fleming has brought the same case on behalf of many more than 50 plaintiffs.[3] As this Court stated, these antics compel an "inevitable inference that [Fleming] . . . hopes to avoid the prohibitions of SLUSA." Fleming Firm Order, at 4. But there is no reason this Court should countenance such antics. The Court should retain jurisdiction, and should deny plaintiffs' motions.

Plaintiffs concede that these cases satisfy all of the following requirements for removal under SLUSA: the actions allege claims under state law, those claims effectively allege material

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[1] Because the motions to remand set forth virtually identical arguments, Andersen responds to both with this single memorandum.

[2] The Court has already acknowledged the existence of five Fleming suits. See Fleming Firm Order, at 2 ("The Jose case represents the fifth in a series of lawsuits filed by Fleming & Associates, L.L.P. on behalf of shareholders of Enron Corporation who allege defendants defrauded them."). Fleming has since filed at least two more, Pearson and Delgado. Five of the seven – Rosen, Odam, Ahlich, Pearson, and Delgado – are pending before this Court.

[3] As the Court has noted, Fleming represents approximately 750 individuals in connection with the Enron-related matters. Fleming Firm Order, at 3.

misrepresentations and omissions in connection with the purchase of a security, and the type of security at issue is a "covered security" as defined in SLUSA. In the circumstances presented here, permitting plaintiffs to prevail on their remand motions, based upon the sole argument that these cases are not "covered class action[s]", will undermine SLUSA altogether and is contrary to Congress' clear intent.[4]

Additionally, this Court should retain jurisdiction because plaintiffs have alleged removable federal question claims – insider trading claims – and because plaintiffs' other state law claims, even if not preempted by SLUSA, are removable under this Court's supplemental jurisdiction.

ARGUMENT

In 1995, Congress passed the Private Securities Litigation Reform Act ("PSLRA") to provide uniform standards for class actions and other proceedings alleging violations of the federal securities laws. Among other things, the PSLRA imposed heightened pleading requirements in securities fraud actions. Seeking to avoid this hurdle, as well as other features of the PSLRA, plaintiffs in securities class actions began to bring suit in state courts. Because Congress perceived that suits being brought in state court often involved federal securities claims in the guise of state law claims, Congress in 1998 moved to close this loophole by enacting SLUSA. See Coy v. Arthur Andersen LLP, No. 01-CV-4248, slip op. at 11 (S.D. Tex. Feb. 6,

[4] Plaintiffs rely on Bullock et al. v. Arthur Andersen et al., No. A-02-CA-070-H (W.D. Tex. March 5, 2002), in which the court did not address Fleming's efforts to manipulate around the provisions of SLUSA and remanded the Bullock case on narrow definitional grounds. However, this Court's decision to enjoin Fleming from filing additional lawsuits throughout the State of Texas, and its recognition that Fleming's actions constitute a blatant case of nose-thumbing at Congress and SLUSA, is based upon a more appropriate reading of SLUSA that appropriately takes into account the legislative purpose and spirit of the statute.

2002); Wald v. C.M. Life Ins. Co., No. Civ. 3:00-CV-2520-H, 2001 WL 256179, at *4 (N.D. Tex. Mar. 8, 2001).

SLUSA precludes plaintiffs from maintaining "covered class actions" alleging state law claims for losses suffered due to material misrepresentations made in connection with the purchase or sale of certain securities, 15 U.S.C. § 78bb(f)(l), and provides that these class actions "shall be removable to the Federal district court for the district in which the action is pending," 15 U.S.C. § 78bb(f)(2).[5]

A. The Petitions Plainly Allege State Law Claims in Connection With Purchases of a Covered Security

A case is removable under SLUSA if: 1) it is a "covered class action" as defined by SLUSA; (2) it brings causes of action that are facially based on state law; (3) it involves a "covered security" as defined by SLUSA; (4) it alleges that defendants have "misrepresented or omitted material facts"; and (5) it alleges that the misstatements were made in connection with the purchase or sale of the covered security. Coy, No. 01-CV-4248, at 14; see also Green v. Ameritrade, Inc., 279 F.3d 590, 596 (8th Cir. 2002); Hardy v. Merrill Lynch, Pierce, Fenner & Smith, No. 01 civ. 5973 (NRB), 2001 WL 1524471, at *3 (S.D.N.Y. Nov. 30, 2001).

There is no dispute that the four latter requirements are satisfied here. The claims are all brought under Texas law. See Pearson Original Petition, ¶¶ 96-116; Delgado First Amended Original Petition, ¶¶ 96-116. The Petitions, which are nearly identical to each other and to the other Fleming complaints, allege that Enron stock "was listed and actively traded on the NYSE,"

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[5] In doing so, Congress placed these state-law class actions beyond the ambit of the well-pleaded complaint rule relied on by plaintiffs. See Verlinden B.V. v. Central Bank of Nigeria, 461 U.S. 480, 494 (1983). Indeed, one of the requirements for removal under SLUSA is that the action be "based upon the statutory or common law of any State." 15 U.S.C. § 77bb(f)(1) (emphasis added). Thus, like the artful pleading doctrine, see Terrebonne Homecare. Inc. v. SMA Health Plan, Inc., 271 F.3d 186, 188 (5th Cir. 2001), SLUSA does not allow a plaintiff to avoid removal simply by cloaking federal claims in state law.

Pearson Pet. ¶ 91, Delgado Pet. ¶ 91, a fact that qualifies it as a "covered security" under SLUSA, see 15 U.S.C. §§ 78bb(f)(5)(E), 77r (b)(1)(A). Although the claims facially sound in fraud, negligence, and civil conspiracy, they substantively allege that Andersen misrepresented material facts in connection with, inter alia, plaintiffs' purchases of Enron stock. Pearson Pet. ¶ 97 ("The Defendants . . . made various untrue and deceptive statements of material fact and omitted to state material facts" allegedly "to induce Plaintiffs to purchase and/or retain Enron common sock at artificially inflated prices"); Delgado Petition ¶ 97 (same). Nowhere in its motions to remand nor in its supporting memoranda does Fleming contest these conclusions.

B. Plaintiffs' Claims Form Part of a "Covered Class Action"

This Court should deny plaintiffs' motion to remand because these complaints are part of Fleming's manipulative scheme to evade SLUSA's removal provisions. Plaintiffs' sole contention is that these cases are not "covered class actions" because they do not meet the 50 person threshold. See 15 U.S.C. § 78bb(f)(5)(B)(i)(I). However, Fleming has announced that it represents over 750 clients who seek or will seek recovery related to Enron's financial difficulties from Andersen and the other defendants. See Fleming Firm Order, at 3. Each of Fleming's lawsuits "recites essentially the same facts giving rise to essentially the same claims against essentially the same defendants." Fleming Firm Order, at 5. Fleming "is careful to point out that his suits are not denominated class actions and they do not aggregate 50 or more plaintiffs in any one suit. The inevitable inference is that he thereby hopes to avoid the prohibitions of SLUSA." Fleming Firm Order, at 4.

SLUSA was adopted to ensure that certain actions that are, in substance, federal securities laws claims are not brought in state court, under state law. Fleming Firm Order, at 4; Coy, No. 01-CV-4248, at 11. Just as "artful pleading" may not be used to defeat removal, see,

e.g., Terrebonne, 271 F. at 188; Aaron v. National Union Fire Ins. Co., 876 F.2d 157, 1161-62 (5th Cir. 1989), so too "artful filing" of the kind engaged in here should not permit avoidance of Congress's clear intention to preempt all claims covered by SLUSA. "Clearly SLUSA was enacted to prevent just such gamesmanship . . . ." Fleming Firm Order, at 4.

In the legislative history to SLUSA, Congress directed courts to remain vigilant against attempts to evade its proscriptions, and made it clear that SLUSA gives them the authority to do so. With regard to the "covered class action" definition, the Senate stressed that SLUSA was designed not only to cover traditional class actions, but also other procedural devices that might have the same effect, even though they might not technically qualify as class actions under Fed. R. Civ. P. Rule 23. The Senate warned that certain "suits may function very much like traditional class actions . . . . They accordingly may be abused by lawyers who seek to evade the provisions of this Act . . . ." S. Rep. No. 105-182, 1998 WL 226714, at *7 (1998). Congress did whatever it could think of to prevent abuse of its class action definition. But it also empowered courts with the flexibility to prohibit unforeseen attempts to circumvent SLUSA:

> Finally, while the Committee believes that it has effectively reached those actions that could be used to circumvent the reforms enacted by Congress in 1995 as part of the Private Securities Litigation Reform Act, it remains the Committee's intent that the bill be interpreted broadly to reach mass actions and all other procedural devices that might be used to circumvent the class action definition.

Id. at *8 (emphasis added).

One court has already cited the Senate Report and held accordingly that "[a] rule that allows a plaintiff to defeat a defendant's right to remove a class action through . . . a hollow procedural maneuver would surrender [SLUSA's] application to the class action plaintiffs the statute seeks to keep at bay." Gibson v. PS Group Holdings, Inc., No. 00-CV-0372, 2000 WL 777818, at *4 (S.D. Cal. June 14, 2000) (rejecting plaintiffs' attempt to avoid SLUSA by

omitting a claim for damages, but remanding on other grounds). Another court found similarly that "[a]ccording to Congress, [SLUSA] should be 'interpreted broadly to reach mass actions and all other procedural devices that might be used to circumvent the class definition.'" Bertram v. Terayon Communications Systems, Inc., No. 00-CV-12653 (SVW), 2001 WL 514358, at *2 (C.D. Cal. March 27, 2001) (holding that plaintiff could not avoid SLUSA simply by seeking equitable relief rather than damages) (emphasis added) (quoting Gibson quoting Senate Report).

Here, Fleming's actions constitute a clear abuse of the SLUSA provision permitting certain small, non-class actions to remain in state court. As this Court found:

> It is now abundantly clear, contrary to the inferences [Fleming] wished the court to draw from [its] representations on January 30, 2002, that in the absence of an injunction prohibiting Fleming from filing new actions and seeking emergency relief, Fleming will proceed on a county-by-county basis through the State of Texas filing actions and seeking the same emergency injunctive relief undertaken in the Bullock, Ahlich, and Jose cases.

Fleming Firm Order, at 7-8. Although plaintiffs attempt to counter by arguing that, for better or worse, they are merely exploiting a loophole in SLUSA, statutory interpretation is not blind to the distinction between invoking an exception and abusing it, and SLUSA cannot be read to authorize removal in these circumstances. In particular, the various lawsuits brought by Fleming should not be naively viewed as proceeding separately. Rather, these lawsuits, which collectively make allegations on behalf of far more than 50 people, must be seen as "proceed[ing] as a single action." 15 U.S.C. § 78bb(f)(5)(B)(ii)(II). All actions brought by Fleming arising out of the Enron's financial difficulties constitute, in reality, a single action, and should be removed.

C. Fleming's Cases are "Pending in the Same Court"

Moreover, defendants have a right under Texas law to consolidate all of these actions before a single state court judge. See Tex. R. Jud. Admin. 11.4(h). This rule provides that on a motion for consolidation:

> The presiding judge must grant the motion or request if the judge determines that: (1) the case involves material questions of fact and law common to a case in another court and county; and (2) assignment of a pretrial judge would promote the just and efficient conduct of the cases. Otherwise, the presiding judge must deny the motion or request.

Tex. R. Jud. Admin. 11.4(h). A refusal to grant a consolidation motion is subject to mandamus review by the Texas Supreme Court. See Tex. R. Jud. Admin. 11.5.[6] Accordingly, the actions subject to this right of consolidation are, for all practical purposes, "pending in the same court" under SLUSA. Any other rule would require defendants to go through the empty formality of consolidating the cases in state court, delaying the removal mandated by Congress and thereby facilitating plaintiffs' manipulation of SLUSA. Gaming of the system can be minimized by recognizing that "pending in the same court" encompasses actions that the defendant has a right under State law to consolidate in the same court. This reading of SLUSA avoids needlessly forcing the defendants to go through the procedural formality of consolidating actions that they have a right to consolidate under Texas law.

D. Plaintiffs Allege Federal Question Insider Trading Claims

Notwithstanding the Court's determination of whether plaintiffs' claims are part of a "covered class action" for purposes of SLUSA, something Andersen urges the Court to find, all of plaintiffs' claims were properly removed. Plaintiffs have alleged and seek remedies under

[6] The use of the term "must," accompanied by the express availability of mandamus, make it clear that a determination under this Rule is not discretionary. Therefore, 15 U.S.C. § 78bb(f)(5)(F) is not implicated here.

federal law – specifically, plaintiffs assert insider trading claims. Insider trading claims are creations of federal law. Congress created the private right of action for insider trading in Section 20A of the Securities and Exchange Act of 1934, as amended. 15 U.S.C. § 78t-l(a); Newby v. Enron Corp., C.A. No. H-01-3624, 2002 WL 200956, at *8 (S.D. Tex. Jan. 9, 2002). Disgorgement of insider trading proceeds is a remedy authorized by the Insider Trading and Securities Fraud Enforcement Act of 1988. See 15 U.S.C. § 78t-l(b); Newby, 2002 WL 200956, at *8. Federal courts have exclusive jurisdiction over alleged violations of the Securities and Exchange Act of 1934, such as violations of Section 20A. See 15 U.S.C. § 78aa. Plaintiffs' claims and requests for relief clearly fall within federal court jurisdiction. Plaintiffs claim that certain defendants engaged in illegal insider trading and seek the remedy of disgorgement. See, e.g., Pearson Pet. ¶ 89; Delgado Pet. ¶ 89.

Plaintiffs' insider trading claims are not mere "factual allegations" supporting a state law claim; plaintiffs seek affirmative relief afforded by the federal securities laws. See Pearson Pet. ¶ 101; Delgado Pet. ¶ 101. Moreover, in order to prevail on their conspiracy claim, plaintiffs must prove the underlying wrongs alleged; in this case, the elements of their federal insider trading claims. See, e .g. American Tobacco Co. v. Grinnell, 951 S.W.2d 420, 438 (Tex. 1997) ("Allegations of conspiracy are not actionable absent an underlying overt act or purpose."); Tilton v. Marshall, 925 S.W.2d 672, 681 (Tex. 1996) ("Civil conspiracy . . . might be called a derivative tort . . . . liability for conspiracy depends on participation in some underlying tort for which the plaintiff seeks to hold at least one of the named defendants liable.").[7]

[7] Because plaintiffs allege removable federal claims, Andersen's removal of any non-preempted state law claims is proper pursuant to this Court's supplemental jurisdiction under 28 U.S.C. §§ 1367 and 1441. See Coy, No. 01-CV-4248, at 23-24.

CONCLUSION

For the foregoing reasons, Defendant Arthur Andersen LLP respectfully requests that plaintiffs' motion to remand these actions to Texas state court be denied, and such other relief as this Court may deem just and proper.

Dated: Houston, Texas
March 28, 2002

Respectfully Submitted,

By: Rusty Hardin by Andrew with permission.

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CERTIFICATE OF SERVICE

I hereby certify that on this 29 day of March, 2002, the foregoing Opposition to Plaintiffs' Objection to Consolidation was served on

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